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# **EIOPA's first set Guidelines for Solvency II**

IRSG meeting 29 April 2014, Frankfurt

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## Content

- 5 areas: Pillar 1 (TP, OF, SCR, Valuation), Internal Models, Governance and ORSA, Equivalence, SRP

## Process

- Consultation June – end August
- Final draft November
- Translation December – beginning February 2015
- Comply-or-explain February-end March
- Available for start of approval process from 1 April 2015

## Areas of general focus

- Convergence, proportionality, relevance and quality of the GL
- For internal models, governance and ORSA: focus on new elements compared to the preparatory package



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# **Pillar 1 (Valuation, technical provisions, own funds, solvency capital requirements, Group Solvency Calculation)**

# Valuation of assets and liabilities other than technical provisions

- Objective: Provide further guidance on the use of IFRSs for the purposes of a market-consistent valuation
- Main elements:
  - Spell out which IFRSs are applicable
  - Guidance on alternative valuation methods
  - Materiality and proportionality considerations

Final decision on the GL and their inclusion in set 1 to be based on BOS decision 21 May pending view on content of the DA

## Objectives

- To increase consistency and convergence of professional practice for all types and sizes of undertakings across Member States in calculating their technical provisions.

## Main Elements

- Valuation of Technical Provisions
  - Broadly divided into Data Quality, segmentation, assumptions setting, choice of methods and validation for the TP calculation.
  - Particularly relevant to actuaries and others who may be appointed to carry out the tasks of the actuarial function, e.g. coordinating and validating TP valuation.
- Contract Boundaries
  - For determining a boundary between existing and future business and thus in order to determine which obligations in regard to future premiums arise in relation to a contract.

## Background

- Own funds items are classified into 3 tiers depending on their ability to absorb losses (classification based on general characteristics in Directive, more detailed features in the delegated).
- Basic and ancillary own funds (AOF)

## Main elements

- Convergent application of the classification criteria and guidance on classification of main types of AOF items (as Tier 2 or Tier 3)
- Set out several supervisory approval processes (e.g. classification of 'items not on the list')
- Guidance on identification and treatment of ring-fenced funds
- Guidance on identification and treatment of related undertakings, including strategic participations

## Background and main elements

- Market risk
  - Treatment of short positions, securities lending agreements, hybrids and employee benefit liabilities, and calculation of duration in certain situations
- Look through
  - Look-through approach applies to certain investments (e.g. collective investment undertakings)
  - Guidelines cover, (1) Situations where the look-through approach has to be applied, (2) calculation in the case of indirect exposures to underwriting risk like cat bonds, (3) Treatment of indirect exposures within indirect exposures (e.g. funds investing in other funds)
- Basis Risk
  - Undertakings can only include the effect of risk-mitigation techniques when calculating the SCR if these techniques do not result in material basis risk. Guidelines cover the criteria for existence of basis risk

## Background and main elements

- Life underwriting risk
  - Calculation of the stresses to mortality, longevity, disability-morbidity inception and disability-morbidity recovery rates
  - Treatment of contracts which provide for benefits in different states of disability
- Health Catastrophe risk
  - Undertakings have to account for mass accident, accident concentration and pandemic risk.
  - Guidelines address quantities necessary to compute the capital requirement for health catastrophe risk and data to be used
- Loss absorbing capacity
  - The calculation of the SCR reflects that Some losses are shared with policyholders (lower discretionary benefits) and governments (lower tax)
  - Guidelines address level of granularity, assumption about future management and other elements of the calculation.



# SCR Catastrophe risk (Standard Formula) (3)

## Background and main elements

- Application of reinsurance
  - Cover steps to apply outward reinsurance in respect of catastrophe risk: (i) specification of events, (ii) disaggregation of loss, (iii) application of outwards reinsurance, (iv) re-aggregation of net losses and (v) documentation and validation. They also cover the application to groups.
- Application of the Man-Made Liability
  - Cover the determination of the number of liability risks with the largest limits in each of the liability risk groups needed as input to apply reinsurance cover.
- Allocation of insurance policies to liability risk groups for the man-made liability
  - Set out how liability policies should be allocated to the 5 risk liability groups.
  - Address liability insurance sold on a packaged basis and the necessary unbundling.

## Background

- Undertakings may use undertaking-specific parameters in the calculation for certain sub-modules of the standard formula
- The approval process for USP is covered in the ITS

## Main elements

- Data quality
- Adjustments to data
- Use of external data
- Role of expert judgement

- **Objectives:**

- Clarity and further specify group solvency calculation requirements, in particular with regard to:
  - Scope of group supervision in the context of third-countries
  - Application of 'mutatis mutandis' of solo solvency calculation at group level
  - Calculation of group solvency when applying accounting consolidation method, deduction and aggregation method and combination of methods

- **Main elements:**

- Assessment of availability of Own Funds at group level and the treatment of minority interests
- Treatment of ring-fenced funds
- Treatment of insurance holding companies and mixed financial holding companies for the purpose of group solvency calculation
- In addition, GLs set criteria for identifying subsidiaries with limited liability and specify their treatment



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# Internal Models

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- Objective: Provide guidance to undertakings on the use of internal models under Solvency II and to supervisors to assess models
- Main elements:
  - o Similar content as preparatory GLs
  - o Further guidance to undertakings on how to fulfil internal models requirements
  - o Functioning of colleges for internal models for groups



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# Governance and ORSA

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1. General governance issues
2. Remuneration
3. Fit and proper
4. Risk management
5. The prudent person principle
6. Own fund requirements and the system of governance
7. Internal controls
8. Internal audit function
9. Actuarial Function
10. Valuation of assets and liabilities other than technical provisions
11. Outsourcing
12. Group governance specific issues

- Guidelines are based on the preparatory Guidelines for the Forward Looking Assessment on Own Risks (based on ORSA principles)
- Main elements:
  - o 'Governance' of the process
  - o 3 Assessments
  - o Reporting / documenting
  - o Group specific





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# Supervisory Review Process

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# Guideline on Supervisory Review Process (SRP)

- Objective:
  - To attain consistent outcomes through the convergence of supervisory processes and practices
  - But also ensure sufficient flexibility for NSAs to be able to appropriately adapt their actions on a case-by-case basis, taking into account the specificities of the undertakings and groups involved, their own markets and other supervisory priorities
  
- Main elements:
  - A first part on the general principles to be applied by supervisors when performing the SRP (consistency, proportionality, etc.); and
  - A second part that describes the several steps of the process.



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# Equivalence

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- Objective: to ensure that group supervisors follow a consistent approach based on the Equivalence criteria set in Delegated Acts and mitigate risks on different outcomes
- Main elements:
  - o a detailed description of the process national supervisory authorities should follow when undertaking the assessment at national level;
  - o a questionnaire which must be used for collecting the information needed from the 3rd country/undertaking concerned.